No. 18,224

IN THE

United States Court of Appeals

For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,* vs. CLAUDE C. WOOD COMPANY, *Respondent.*	}

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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Commissioner of Internal Revenue, *Petitioner,* vs. Claude C. Wood Company, *Respondent.*	

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BRIEF FOR THE RESPONDENT

QUESTION PRESENTED

Whether the Tax Court erred in holding that the taxpayer "is entitled to deduct percentage depletion on rock, sand and gravel, which it removed from property that had already been dredged-mined for gold." (R. 59.)

STATUTE INVOLVED

The applicable statute is set forth in Appendix A of the brief for petitioner.

STATEMENT

Respondent herein conducts a rock, sand and gravel business on three properties that had previously been dredged-mined for gold by Gold Hill Dredging Company. The properties are commonly referred to as the "Featherston," "Putnam," and "Wright."

The Tax Court found, inter alia:

(a) "The Putnam, Wright, and Featherston properties had never been mined for aggregates by Gold Hill Dredging Company or any prior owners, and no aggregates were removed from these properties until the operations were commenced by petitioner." (R. 62.)

(b) "Respondent produces approximately 15 kinds of rock and sand products." (R. 67.)

(c) In the process of removing the gold from the sand and aggregates the gold-dredge did not crush or change the size of the aggregates, nor were any chemicals added in the process. (R. 65.)

I

THE INTERNAL REVENUE CODE GRANTS A FIVE PER CENT DEPLETION ALLOWANCE IN CASE OF MINERALS OR OTHER NATURAL DEPOSITS OF GRAVEL, SAND, ROCK, ETC.

The Internal Revenue Code of 1954, Section 611 (a) provides that in the case of mines or other "natural deposits" there shall be allowable as a deduction in computing taxable income a reasonable allowance for depletion. Section 613 (b) of the Internal Revenue

Code, 1954, grants a five per cent depletion allowance in the case of mines and other "natural deposits" of gravel, sand, riprap, road materials, concrete aggregates, or for similar purposes.

The deficiency notice mailed by petitioner to taxpayer stated in part as follows:

> "It is determined that on the mining of aggregates from tailings, which results from the acquisition of the right to remove sand and gravel from the residue of prior gold dredge-mining along the Mokelumne River on the property of the Gold Hill Dredging Company, no percentage depletion is allowable pursuant to the provisions of the Internal Revenue Code.
>
> "It is held that once a deposit has been mined the residue does not revert to a natural deposit; therefore the aggregates subsequently were not removed from 'natural deposits' . . .". (R. 14, 15.)

In the brief presented by petitioner prior to the decision of the Tax Court under the heading "Question Presented" we find the following:

> "Did petitioner's business consume *natural deposits* of rock, sand and gravel when it consumed rock, sand and gravel from property that had been dredged-mined for gold?" (Emphasis added.)

Based upon the foregoing statements, the theory upon which the case was actually tried before the Court was correctly summed up by the Court when it stated:

> "The issue, as stated by respondent, is: 'If the rock, sand, and gravel located on these properties

> qualify as a natural deposit or mineral-in-place, then petitioner is entitled to a deduction for depletion.' " (R. 70.)

II

THE TAX COURT'S FINDINGS OF FACT SHALL NOT BE SET ASIDE UNLESS CLEARLY ERRONEOUS.

The Tax Court, after hearing all of the facts and evidence presented (incidentally, the Commissioner presented no testimony or witnesses at the trial) and after having read the briefs that were presented by the respective parties the Court concluded and *found,* in addition to the above findings, that, *as a fact:*

> "The aggregates taken from the Putnam, Wright, and Featherston properties in the year in question were *natural deposits that were mined* by petitioner." (R. 67; emphasis added.)

Petitioner now urges that the Court's finding that the aggregates were natural deposits is not binding on this Court. In disagreeing with the Tax Court, the Commissioner seems to forget that fact finding is the business of that Court. "It is for the trial Court, upon consideration of an entire transaction, to determine the factual category in which a particular transaction belongs." *United States v. Cumberland Public Service Co.,* 338 U.S. 451, 456 (1950). Furthermore, in the familiar words of Rule 52 (a) of the Federal Rules of Civil Procedure, "findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial judge to judge

of the credibility of witnesses." Under Rule 52 (a) findings of fact may not be easily discarded even if the facts might have been differently found. *United States v. Real Estate Boards,* 339 U.S. 485, 495 (1950); *United States v. Yellow Cab Company,* 338 U.S. 342 (1949); *Stout v. Commissioner,* 185 F. 2d 854 (6th Cir. 1950). A finding is "clearly erroneous" only when "the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *United States v. Gypsum Co.,* 333 U.S. 364, 395.

Petitioner would have this Court ignore the foregoing established principles of law by suggesting that the Tax Court did not apply "the proper legal standard established by statute." It is submitted that this suggestion is untenable and that the facts as found by the Tax Court should not be set aside. The Tax Court having found that the aggregates in question were "natural deposits that were mined by petitioner" and were deposits of a type that qualify under the Code, this entire case should be settled and resolved in favor of respondent without any further question or argument.

III

THE TAXPAYER'S AGGREGATE DEPOSITS WERE "OTHER NATURAL DEPOSITS" WITHIN THE MEANING OF THAT TERM IN SECTIONS 611 AND 613.

The precise issue presented to this Court has been decided adversely to petitioner not only by the Tax Court in this case, but also in *Pacific Cement & Ag-*

gregates v. Commissioner, 31 T.C. 136 (October 23, 1958). The Court will note that in the Memorandum Findings of Fact and Opinion (R. 59 at R. 68) *Pacific Cement* is referred to as being almost identical in facts to the present case and the Court quotes from its decision at pages 139, 140 and 141. This Tax Court has therefore *found* against petitioner on two occasions, *as a fact,* that producers, processors, or miners, of aggregates that had been previously dredge-mined for gold are entitled to a depletion allowance as a "natural deposit."

Petitioner attempts to make the *Atlas Milling Co. v. Jones,* 115 Fed. 2d 61 (C.A. 10, 1940) ((40-2 USTC 9711)), and *Consolidated Chol. G. & S.M. Co. v. Commissioner,* 133 Fed. 2d 440 (C.A. 9, 1943) ((43-1 USTC 9298)) apply to the present case. Both of these cases had been decided prior to *Pacific Cement* and the two cases were discussed by the Court in the *Pacific Cement* decision and in reviewing these two cases the different factual situation was noted and the Court stated:

> "In the Atlas Milling Co. case, the mineral was mined and removed to the mill where it was processed and the ore extracted. The residue was dumped and it was this residue which was acquired by the taxpayer in that case and reworked by a more modern process. The Court held that such residue was not a mine and the reprocessing of it was not the working of a mine and pointed out the fact that the taxpayer there had no interest in the mine from which the ore had originally been taken. The petitioner in the *Con-*

> *solidated Chollar Gould* case, supra, had claimed percentage depletion 'from the extraction of gold by the petitioner from certain dumps consisting of rocks and ore material which had never been milled or processed in any way but which had been deposited upon lands owned by the petitioner ((from mines not located on such lands)) many years prior to the acquisition of said lands by the petitioner.' "

It is interesting to note that petitioner's brief nowhere refers to the California case of *State of California v. Natoma Company,* 25 Cal. Rptr. 363, 208 ACA 711, decided in October, 1962. The lands in controversy had been dredged-mined for gold between 1900 and 1925 and the question presented to the Court was whether the dredger tailings remaining after the gold had been removed was realty or personalty for the purposes of condemnation. The Court held the aggregates to be realty. Had the Court considered the aggregates a "waste," a "residue," a "dump" etc., it would have held it to be personalty.

The language quoted from the cases cited by petitioner in support of its position are misleading. In the *Atlas, Kohinoor Coal, Soil Builders,* etc., the product created by nature was changed in size, shape or content by mechanical, chemical or other methods when ore was extracted. The Court makes this point abundantly clear in *Pacific Cement* when it states:

> "In the instant case there is nothing that resembles a dump or residue remaining after the ore has been milled and the concentrates removed

therefrom. The aggregates on the Fair Oaks property cover an extended area southward from the banks of the American River and are the identical aggregates which were placed in the area by nature, the only difference being that petitioner's predecessor in interest operated by dredge on the deposit as it existed, picking up the sand and gravel, extracting the gold therefrom, and dumping the sand and gravel, minus the gold, in substantially the same place where it had picked it up. *There has been no prior mining* of the Fair Oaks property *for the purpose of extracting aggregates* and *there has been no change in the size or form of the aggregates.* When 'Natomas Company completed its process *they were the identical aggregates which existed when the process had been commenced.* Petitioner leased the Fair Oaks property and worked the identical deposit for aggregates for the first time and in the place where the sand and gravel had been originally laid down by nature. The fact that, in extracting the gold, the sand and gravel had been stirred up does not warrant respondent in taking the position that petitioner was not working a natural deposit in place or that petitioner did not have an economic interest in the very property from which the deposit was being extracted. In our opinion, the rock, sand, and gravel recovered by petitioner from the Fair Oaks property *were from 'natural deposits' and constituted 'minerals in place'* as those terms are used in the statutes and regulations previously cited.

"In conclusion, we hold that the respondent erred in disallowing depletion claimed by petitioner on the Fair Oaks property." (Emphasis added.)

There are no tailings or waste material and low-grade ore placed on the surface of the Putnam, Wright and Featherston properties. The entire deposit of aggregates constituted a natural deposit which had been placed there by nature eons ago. The deposit had been slightly disturbed by the extraction of gold, but the deposit of aggregates, as such, remained as originally created by nature.

As previously stated the main issue to be determined in this case is whether the aggregates in question are "a natural deposit," if they are so found to be then the depletion allowance must be permitted to taxpayer. If the aggregates in question are not "natural deposits" then of necessity they are "waste or residue of prior mining." In attempting to argue that the aggregates are "waste or residue of prior mining" at page 20 of the brief of the petitioner, the *Consolidated* opinion is referred to by counsel to the effect that "mere severance and piling of ore-bearing rock, without the extraction of a mineral, was sufficient to make the mine tailings residue." This is a misleading statement without a full statement of the facts. The ore in the *Consolidated* case was dug or removed from the property of one person some distance away to the property of another person. The extraction and mining of the ore did not take place until after the material had been deposited on the second persons' property. Clearly, when the mining took place it was not a "natural deposit." As previously set forth the Court in *Pacific Cement* noted and made this factual distinction between the *Consolidated*

cases and the case where the prior operation was gold dredge-mining. The brief at page 20, again attempts to confuse the issue by stating that in the instant case the "gold was extracted from the ore-bearing aggregates." The attempt is being made to create the impression that the gold was imbedded in the aggregates and had to be extracted therefrom. The uncontrovertible evidence and testimony was that the gold in question was "free placer gold." (R. 90.) The operation of the dredger merely extracted the free gold from amongst the sand.

The Court's attention is called to petitioner's brief, page 14, wherein *Cordell v. Scofield* (D.C. Tax, 1958), 58-2 USTC is cited only. The reason is obvious. In this case clay, sand, and other materials were dredged from a ship channel and piped to properties of a navigation district and deposited behind levees for disposal. Taxpayers (a partnership) mined the clay and sand from the properties under leases with the navigation district and processed the clay into burnt brick and tile. The Commissioner denied the partnership a depletion deduction contending that the clay and sand were not natural deposits. The Court held that the partnership's *clay mining operation did not differ in any way* from any other clay mining operation conducted by a brick company and, accordingly, allowed depletion on the clay. The Court found:

> "The clay deposit in the 'Old Filter Bed Tract' was dredged and piped behind levees in about 1918 when the Houston Ship Channel and turning Basin were deepened and widened. There

> was overburden on the clay in the 'Old Filter Bed Tract' in 1938 and subsequently. By 1938, heavy vegetation had grown on the land, including quite a bit of timber, with trees as large as 20″ in diameter at the trunk. This overburden had to be removed in order to mine the clay in the same way that other clay deposits are mined.
>
> "The mining operation conducted by the partnership in the 'Old Filter Bed Tract' did not differ in any way from any other clay mining operation conducted by a brick company."

The Court also held that depletion was allowable in connection with the sand, which had been deposited during the widening and deepening of the ship channel.

The last cited case appears to be the only one where a natural deposit has been entirely removed from its original place and is still considered a natural deposit in the new place. The Putnam-Wright-Featherston natural deposit has not been removed and *a fortiori* remains a natural deposit in its original place.

The Fifth Circuit Court of Appeals in April, 1960, in the case of *Soil Builders, Inc. v. United States of America,* 227 F. 2d 573, considered the question of granting a depletion allowance in the mining of the property for hard phosphate which mining resulted in the creation of a colloidal or soft phosphate a quarter to a half mile downstream from the operation. The mining of the hard phosphate was accomplished by removing from a frame or block of hard phosphate the sand, clay, and soft particles of phosphate from

the openings in the blocks. The Court found that the original mining was of phosphate rock and that the mining operation then before the Court was for colloidal or soft rock phosphate. The Court reviews the *Atlas Milling Co. v. Jones* (supra) and other cases and notes that in all of these cases the reworking activity was to recover more of the same mineral that had been the object of the original mining. The Court stated:

> "The colloidal phosphate not only is not in its natural location; it is not even in its natural state. In effect, it is a refined product, refined by the removal from it of all sand (silicon dioxide) and non-phosphate clay. The refinement process and the removal process were one and the same. By this process a deposit was undoubtedly made but it was not a natural deposit; it was man made."

At page 15 of the brief for petitioner the *Soil Builders* case is cited as authority for petitioner's argument, and it is therein stated:

> "The mining processes engaged in there were quite similar to those in this case."

It is respectfully submitted that only a cursory reading of the facts in the *Soil Builders* case and the testimony in the case before the Court conclusively demonstrate that there is no similarity in the two mining processes. Furthermore the brief fails to call this Court's attention to the fact that the *Soil Builders* case, *Pacific Cement & Aggregates, Inc. v. Commis-*

sioner (Supra) was discussed and the factual situation in this latter case reviewed by the Court. In other words, *Soil Builders did not overrule, change, or modify the decision made* in *Pacific Cement & Aggregates, Inc. v. Commissioner*, but distinguished the facts in this latter case from all other decisions that had theretofore been decided *and in fact approved the decision of Pacific Cement & Aggregates v. Commissioner.* The Court concluded that the facts in this *Pacific Cement* case were distinguishable from the *Soil Builders* case in that "(1) that the taxpayer claims a deduction under the classification of phosphate rock, which is exactly what was previously mined, and (2) that the colloidal phosphate here was not, when removed, either a natural deposit or in its natural state."

The foregoing cases, except the *Pacific Cement & Aggregates* case, have been cited to indicate that in each one of them there was involved a tailings pile, a refuse pile, a pile of waste or a culm or refuse bank, or some other similar residue of ore resulting from previous mining operations. In each of the cases the ore in question had been removed from the ground, the ground was processed by mechanical or chemical methods and the remaining ground was deposited on the surface of the earth outside of the mine from which it was extracted.

In the case before the Court there is nothing that resembles a refuse or tailings pile or a residue of low-grade ore resulting from prior mining operations, a culm bank or refuse bank, or any other type of residue

from prior mining operations. The aggregates in this case are the identical aggregates which were placed in the area by nature, the only difference being that the gold had been extracted from the sand, and the aggregates were thereupon returned to the surface of the earth at a distance of approximately 150 feet from their original position. There has been no change in the size or form of the aggregates. In going through the dredge the aggregates were only washed. They were not treated chemically, nor were they crushed in any way. When the dredging operation was completed, the aggregates were the identical aggregates which existed when the process had been commenced. The gold was "free gold" in the sand, and the sand remained after the gold dredging operation had been completed. (R. 90.)

The testimony of Herbert L. Coney, the person who constructed and operated the dredge in question, respecting the foregoing statements is as follows (R. 90):

> "Q. Now, this gold in effect that has floated or been washed down from the Sierras, is that correct?
>
> A. That is correct.
>
> Q. This gold that you dredge-mined, in what state was that gold? Is it embedded in the rocks or aggregates?
>
> A. No. It is a free placer gold.
>
> Q. It is a free placer gold?
>
> A. That is correct.
>
> Q. It is not affixed or——
>
> A. No.

Q. So that the process of the gold dredge is to wash the sand and separate the gold from it so that the gold will drop, is that kind of——

A. That is correct.

Q. ——a layman's description of it?"

Mr. Coney's testimony regarding what happens to the aggregates themselves when they go through the dredge, the Court's attention is called to his testimony in this regard at R. 91 and R. 92.

"Q. Now, when the aggregates are discharged over the stacker conveyor at the stern, what if anything is done to the aggregates by the dredger?

A. Well, nothing. They are merely floating lodes on through. They don't change their shape in any form. They're merely dug and they're washed as they go through the screen, and that is the only thing that is done to them.

Q. What, you say they were a floating what?

A. A floating load going through the trammel in there.

Q. In other words, there is no machinery or anything on the dredger that crushes any of these aggregates?

A. No.

Q. There are no cemicals added to them?

A. No.

Q. Are they in the same physical shape, size and content when they are picked up by the bucket line as they are when they are discharged over the stacker conveyor?

A. That is correct.

Q. The difference is that instead of them being in front of the dredge at the time they are

picked up, they are then deposited to the rear; is that correct?

A. That is right. They are transported the length of the dredge, that is all.

Q. And that is the only thing that happens?

A. That is all.

Q. Is that the only thing that happens to them?

A. That is the only thing that happens to the aggregates.

Q. Now, would you briefly describe to the Court what [23] happens to the ground when you go in and gold dredge it?

In other words, you've got some terrain, a gold dredger goes in, and when you operate you move out, and what has happened?

A. Well, the simplest explanation I could give to the Court would be that we merely turn the ground upside down. What is on top when we are finished is on the bottom.

Q. You mean what was on the top when you started is on the bottom when you have finished; is that correct?

A. That is correct.

Q. And it has been moved the length of the dredger?

A. Of the dredger.

Q. And other than that, is there any change to the shape and size of the aggregates that go through the dredger?

A. None at all."

The disturbance of the aggregates caused by the gold dredge did not destroy them as a natural deposit. When the dredge mining operation was completed, the

aggregates were returned to the earth in approximately the same location as they had been previously. They were not in any way processed as aggregates, nor had they been mined as aggregates. Also, no other person, firm, or corporation, worked or operated these properties for the removal of aggregates except petitioner. (R. 93, 120, 121.) The Tax Court so found. (R. 62.)

The Court held in the *Atlas Milling Co.* (Supra) and similar cases that the material there worked on by the taxpayer, for which a depletion allowance was not granted, was not a material that was a natural deposit. Those materials upon which the taxpayers were working were in different form, shape, size, and content than that created by nature. Those materials had been "worked over" by man, and the refuse remaining cannot be classified as a natural deposit. *In the instant case*, however, *the aggregates worked on by taxpayers were in exactly the same form, size, shape, and relative location as created by nature.* The aggregates in question had never been processed, worked on, or mined by any person prior to the time taxpayer commenced its operations. These aggregates are natural deposits, and petitioner is entitled to a percentage depletion allowance in accordance with the language of the Code.

IV

WHETHER TAXPAYER WAS A "PURCHASER" OF THE AGGREGATES IS IMMATERIAL.

The final point made in the brief for the petitioner is that the taxpayer was the *purchaser* of the aggregates in question, and that the Tax Court did not consider this point. The brief refers to the aggregates, however, as "waste or residue" and being "waste or residue" of prior mining under the regulations, a depletion allowance should not be permitted. As set forth above it is the position of taxpayer that he was not the purchaser of "waste or residue" of prior mining, but rather the purchaser of natural deposits.

The Tax Court decision did consider the fact that taxpayer was a purchaser of the aggregates in question. The three agreements to purchase are summarized and reviewed by the Court in its Memorandum of Findings. (R. 59 to 62.)

As will be noted from a reading of the decision of the Tax Court in its opinion herein, *Pacific Cement* is quoted with approval and particular reference is made to the following language. (R. 69.)

> "* * * We think there might be some reason for the respondent's contention if the property was being worked for aggregates, it does not seem reasonable to say that such aggregates were in the nature of "mineral dumps artificially deposited from the residue.* * *"
>
> "* * * The aggregates on the Fair Oaks property cover an extended area * * * and are the identical aggregates which were placed in the area by nature, the only difference being that petitioner's

predecessor in interest operated by dredge on the deposit as it existed, picking up the sand and gravel, extracting the gold therefrom, and dumping the sand and gravel, minus the gold, in substantially the same place where it had picked it up. There has been no prior mining of the Fair Oaks property for the purpose of extracting aggregates and there has been no change in the size or form of the aggregates. * * * Petitioner leased the Fair Oaks property and worked the identical deposit for aggregates for the first time and in the place where the sand and gravel had been originally laid down by nature. The fact that, in extracting the gold, the sand and gravel had been stirred up does not warrant respondent's taking the position that petitioner was not working a natural deposit in place or that petitioner did not have an economic interest in the very property from which the deposit was being extracted.* * *''

Substitute the names of Featherston, Putnam and Wright for the words ''Fair Oaks'' and the factual situation is identical.

Finally, the Tax Court *did* actually find (and not ''purportedly'') as stated in the brief for petitioner (Pg. 28) that ''The aggregates taken from the Putnam, Wright and Featherston properties in the year in question were '*natural deposits that were mined by* petitioner'.'' (R. 67; emphasis added.)

The arguments made in petitioner's brief were submitted and argued to the Tax Court in this case and presumably to the Tax Court as well in the *Pacific Cement* case and in both cases the Court con-

cluded and found *as a fact* that the aggregates "were natural deposits that were mined by petitioner," (R. 67) and that the depletion deduction should be allowed.

Dated, Lodi, California,
April 3, 1963.

Respectfully submitted,
Robert H. Mullen,
Attorney for Respondent.

CERTIFICATE OF SERVICE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ROBERT H. MULLEN,
Attorney for Respondent.